AP Macroeconomics
Test: Basic Economic Concepts
Instructor's Version

Answers: Free-Response Questions

1. Economic Analysis

   A. What is opportunity cost? (3 points)

   Answer: The opportunity cost of a choice is the value of the next best alternative that wasn't chosen.

   3 points for the complete sentence.

   B. Describe how economists use marginal analysis. (3 points)

   Answer: Marginal analysis involves comparing the additional benefits of a decision to the additional costs of the decision.

   3 points for the complete sentence.

   C. Describe the production possibilities frontier (PPF) and explain what it shows. (3 points)

   Answer: The PPF is a graph showing all of the combinations of production given a certain set of resources. The PPF shows the opportunity cost of a production decision.

   2 points for the first sentence; 1 point for the second sentence.

2. **Define *absolute advantage* and *comparative advantage*.** (6 points)

   Answer: Absolute advantage is the ability of a producer to use fewer resources than other producers. Comparative advantage is when the opportunity cost of a certain kind of production is lower for one producer.

   3 points for each definition.

3. Equilibrium

   A. Draw a graph to show equilibrium price. (3 points)

   Answer: A standard supply-and-demand curve showing E at the intersection of the two curves.

   2 points for the correct graph; 1 point for the label at the intersection.

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B. Describe what happens when demand decreases. (3 points)

Answer: The demand curve shifts to the left, decreasing both equilibrium price and quantity.

1 point for stating that the curve shifts to the left; 1 point each for stating the decrease in price and quantity.

C. Explain what happens when a market is out of equilibrium. (3 points)

Answer: When a market is out of equilibrium, it will move toward equilibrium. Sellers will raise or lower prices depending on conditions. When there's excess demand, they'll raise prices to the equilibrium level, and when there's a shortage of demand, they'll lower prices to attract buyers.

1 point for each sentence.

D. Define *price floor.* What is the effect of a price floor? (3 points)

Answer: A price floor sets a minimum price on a good or service. It keeps the price above the equilibrium. This causes excess supply.

1 point for each sentence.

4. Supply and Demand

A. State the law of supply. (3 points)

Answer: If the price increases, quantity supplied will increase; if price decreases, quantity supplied will decrease — all other things being equal (or *ceteris paribus)*.

1 point for mentioning increase; 1 point for mentioning decrease; and 1 point for mentioning all other things being equal.

B. What causes a change in the quantity demanded? (3 points)

Answer: A change in the quantity demanded is caused by a change in price. Price usually changes because of a shift in the supply curve.

2 points for first sentence; 1 point for second sentence.

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C. Define the price elasticity of demand and explain what makes demand elastic or inelastic. (6 points)

Answer: The price elasticity of demand compares the size of a price change with the size of the resulting change in quantity demanded. This is a measure of how sensitive consumers are to a change in price. If consumers are very sensitive to a change in price — making a great change in quantity demanded when the price changes only a little — then demand is elastic. If consumers aren't sensitive — keeping their quantity demanded about the same, even with big price changes — demand is inelastic. If a good has many substitutes, demand will be elastic. If there are few substitutes, demand will be inelastic.

1 point for each sentence.

5. Explain the difference between a change in supply and a change in the quantity supplied. What might cause each of these kinds of changes? (6 points)

Answer: A change in supply is a shift of the supply curve; a change in quantity supplied is movement along the supply curve. A change in the quantity supplied results from a change in the price of the good; a change in supply may result from just about anything else, including changes in wages, changes in the price of other inputs, or changes in expectations about the future.

2 points for defining each change (4 points total); 1 point for the cause of each change (2 points total).

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